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June 1, 2004

Mr. Michael W. Hill, CPA
City of Lynchburg, VA
P.O. Box 60
Lynchburg, VA 24505

Dear Mr. Hill:

Fitch Ratings has assigned one or more ratings and/or otherwise taken rating action(s), as detailed on the attached Notice of Rating Action.

Ratings assigned by Fitch are based on documents and information provided to us by issuers, obligors, and/or their experts and agents, and are subject to receipt of the final closing documents. Fitch does not audit or verify the truth or accuracy of such information.

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The assignment of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement or other filing under U.S., U.K., or any other relevant securities laws.

We are pleased to have had the opportunity to be of service to you. If we can be of further assistance, please feel free to contact us at any time.

Sincerely,

Cherian George
Senior Director
Public Finance

CG/tv

Enc: Notice of Rating Action
(Doc ID: 2034)

Notice of Rating Action

Bond Description	Par Amount	Rating Type	Rating	Action	Eff Date	Notes
City of Lynchburg, VA General Obligation Public Improvement Bond Anticipation Notes, Series 2004	$7,175,000	Short Term	F1+	New Rating	26-May-2004	
City of Lynchburg, VA General Obligation Public Improvement Bonds, Series 2004	$28,040,000	Long Term	AA	New Rating	26-May-2004	
City of Lynchburg, VA Outstanding General Obligation Bonds	$149,756,000	Long Term	AA	Affirmed	26-May-2004	

The Rating Outlook is Stable.

Tax Supported
New Issue

Lynchburg, Virginia

Ratings

New Issues

General Obligation Public Improvement Bond Anticipation Notes, Series 2004 .. F1+
General Obligation Public Improvement Bonds, Series 2004 .... AA

Outstanding Debt

General Obligation Bonds .... AA

Rating Outlook .... Stable

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New Issue Details

$7,175,000 General Obligation Public Improvement Bond Anticipation Notes (BANs), Series 2004, and $28,040,000 General Obligation Public Improvement Bonds, Series 2004, are scheduled to sell competitively on June 8. The BANs mature serially June 1, 2005–2006, and the bonds mature serially June 1, 2005–2034.

Security: The bonds and BANs are general obligations of the city for which its full faith and credit are irrevocably pledged.

Purpose: The series 2004 bonds and BANs will finance various public improvements, including and addition to and renovation of the E.C. Glass High School.

■ Outlook

The 'AA' rating reflects the City of Lynchburg's strong financial management, moderate debt levels, and mature economy with an above-average, although declining, presence of manufacturing. Income levels remain below average; however, the city is continuing its efforts to attract higher paying manufacturing jobs into designated industrial parks. Future debt needs are manageable and debt burden should remain moderate given the rapid amortization of outstanding bonds and the availability of user fees to support a portion of the city's outstanding general obligation bonds. The Rating Outlook is Stable.

■ Rating Considerations

Located east of Roanoke in the geographic center of Virginia, Lynchburg has effectively dealt with many of the challenges that face economies historically focused on manufacturing while maintaining its role as a retail center for the large surrounding area. Lynchburg also serves as a regional provider of higher education and health care services. The unemployment rate equaled 5.6% as of March 2004, a decrease from the 6% levels reported in 2002 and 2003, which reflected the loss of Ericsson and the overall shrinking technology and communication sector. The unemployment rate, however, consistently tracks below the national average. Ericsson, a leading supplier in the telecommunications industry, reorganized and closed part of its operations in the city in 2002, resulting in a net loss of 1,400 jobs. However, approximately 500 jobs were retained at M/A-Com, a spinoff of Ericsson that produces public safety communication equipment. Per capita income is below average, equaling 74.2% of the state and 78.8% of the nation's figures.

Financial management is strong. The city has formalized policies regarding fund balance and debt affordability along with quarterly reporting, revenue tracking, and midyear budget reviews, better ensuring stable financial operations in the future. Reserve levels are strong and exceed the policy minimum of 7% of general fund revenues. As of June 30, 2003, the city's undesignated general fund balance equaled $17.1 million, or 14% of general fund revenues. Third-quarter estimates for fiscal 2004 show a small operating surplus, but actual results are likely to be better than estimates due to conservative forecasting and a reportedly strong fourth quarter in sales and meals tax revenue. The fiscal 2005 proposed budget includes various tax revenue enhancements and expenditure controls in order to maintain balanced operations and service levels.

Debt levels are manageable and outstanding debt is amortized rapidly. Capital needs outside of the sewer system upgrades are minimal due to the absence of population growth and the presence of an established infrastructure. The six-year $187 million fiscal years 2004–2009 capital improvement program (CIP) addresses capital needs primarily related to transportation, schools, and the water and sewer utility system. Approximately 14% of the CIP is related to the sewer system and compliance with a consent order regarding the combined sewer overflow (CSO) issue, but this is down from the 36% in the fiscal years 2002–2007 CIP. Approximately 61% of the current CIP is funded through general obligation bonds with another 7% financed by revenue bonds.

Debt Statistics

($000)

This Issue	35,215
Outstanding Debt	88,631
Direct Debt	123,846
Overlapping Debt	0
Total Overall Debt	123,846

Debt Ratios

Direct Debt Per Capita ($)*	1,854
As % of Market Value**	3.6

*Population: 66,800 (2003).
**Market value: $3,466,111,000 (fiscal 2002).

Strengths

- Strong financial performance and management, with institution of formal policies.
- Regional retail and employment center for the four-county surrounding area.
- Moderate debt levels, with manageable future capital plans.

Risks

- Below-average income levels.
- Above-average presence of manufacturing jobs.

Debt

Debt levels are moderate, with direct debt representing $1,854 per capita and 3.6% of market value. General obligation debt issued for the water, sewer, and solid waste enterprise funds, approximately 47% of all outstanding debt, are self supported by fees charged by the respective systems. The new bond issue will finance the renovation and expansion of the E.C. Glass High School, as well as other various public improvements. Amortization of the city's total direct debt is above average, with 69.6% retired within the next 10 years.

The $187 million six-year CIP for fiscal years 2004–2009 is primarily funded through general obligation bonds, 61% of the plan, followed by pay-as-you-go sources, 14%; revenue bonds, 7%; and the remaining portion from state and federal grants. Capital needs related to schools, 25% of the plan, and general city functions (including buildings, transportation, economic development, and parks and recreations improvements), representing 40% of the CIP, require the majority of the city's capital investments over the six-year period. Self-supporting water and sewer systems and the improvements related to CSO projects comprise approximately 25% of the total CIP. The city continues to adjust sewer rates and control spending to maintain the self-supporting nature of the enterprise fund.

The city council adheres to several debt affordability policies that guide capital planning and better ensure maintenance of manageable debt levels. These policies include restricting the use of short-term borrowing for current operations, matching the term of the bond issuance with the useful life of the asset, limiting debt service expenditures to 10% of general fund expenditures (including the transfer to the school and reserve allocations), and maintaining tax-supported debt below 5% of assessed value.

Combined Sewer Overflow

To comply with a special consent order issued in 1994, the city is working to separate the storm sewer and sanitary sewer systems, an operation that originally was expected to cost about $200 million. City officials, along with independent counsel, estimate that 89 of the 132 originally identified overflow points have been eliminated which has reduced the CSO discharge by 79%. The majority of the remaining work to be completed occurs in the downtown area, which is projected to be very costly, but actual estimates are not available. The city is pursuing various options for resolving the downtown corridor CSO discharge.

Commonwealth and federal grants historically have decreased the financial burden of the CSO project on the city. Since 1998, the city has received federal grants for the CSO project, with matching grants from the commonwealth. However, due to Virginia's financial position, the city has not received matching grant moneys since 2001, which has slowed the progress of the CSO program. However, the commonwealth allowed the city to adjust the structure of its outstanding Virginia Wastewater Revolving Loan Fund (VWRLF) moneys and

General Fund Summary
($000, Audited Fiscal Years Ended June 30)

	2000	2001	2002	2003
Revenues	108,283	112,954	115,524	117,968
Expenditures	79,422	77,364	78,647	129,060
Net Change	28,861	35,590	36,877	(11,093)
Transfers In	3,704	823	730	1,697
Other Sources	0	0	0	15,649
Transfers Out	0	(10,768)	(4,799)	(6,977)
Other Uses	(32,785)	(30,635)	(31,462)	0
Net Income	(220)	(4,990)	1,347	(724)
Total Fund Balance	27,377	21,235	22,582	21,858
As % of Expenditures, Transfers Out, and Other Uses	24.4	17.9	19.7	16.1
Unreserved Fund Balance	10,345	16,942	18,042	17,104
As % of Expenditures, Transfers Out, and Other Uses	9.2	14.3	15.7	12.6
Undesignated Fund Balance	10,345	16,942	18,042	17,104
As % of Expenditures, Transfers Out, and Other Uses	9.2	14.3	15.7	12.6

lengthen the maturity schedule to 30 years, from 20 years. This move has allowed $20 million more in borrowing capacity that the city plans to issue over the next six years. The capital investment is projected to be over $30 million during this six year period, as opposed to $12 million prior to the restructuring.

While the more costly and time-consuming components of the project remain outstanding, the special order sets three compliance guidelines based on financial capability, as opposed to fixed dates for completion. The city is in compliance with the stipulations outlined in the order. Rates are adjusted annually to meet the maintenance of effort stipulation that the sewer bill be at least equal to 1.25% of median household income (MHI). The debt service coverage of 1.2 times (x) estimated for fiscal 2004 is consistent with the 1.1x requirement, and the sewer operating fund balance equaled the required 25% of the subsequent year's expenses.

Because of these restrictions outlined and the uncertainty of future Virginia Department of Environmental Quality compliance orders, sewer fund operations will have limited financial flexibility until the completion of the project. In addition, the loss of Mrs. Giles Country Kitchen, a subsidiary of Bob Evans Farms Inc., and the temporary shutdown of a paper mill resulted in $650,000 of lost revenue in fiscal 2001, which resulted in a 10% increase in the already above-average sewer rates on July 1, 2002 and the implementation of expenditure controls within the fund. In addition, sewer rates were increased 8.6% on July 1, 2003, and a 4% rate increase is anticipated over the next five years in order to maintain coverage levels and consent order requirements.

Finances

The city's financial position is sound. The unreserved general fund balance at the end of fiscal 2003 equaled $17.1 million, or 12.6% of expenditures and transfers out and 14% of general fund revenues, down slightly from the $18 million, or 15.7% of expenditures and 16% of revenues, recorded in the prior fiscal year due to a decrease in state funding and weak revenue performance. However, the undesignated fund balance surpasses the city's target 10% of revenues level and is well above the 7% of revenues minimum requirement pursuant to city policy.

Third-quarter estimates for fiscal 2004 show a modest surplus in the general fund and an undesignated fund balance equal to 10.3% of revenue, but actual results are likely to be stronger due to conservative forecasting and a reportedly strong fourth quarter in sales and meals tax revenue. The proposed fiscal 2005 budget was set for approval on May 25 but has been delayed until June 8 pending further discussion with school officials. The city's budget includes additional revenues from the state, primarily for education, and various tax increases in order to maintain structural balance and service levels. Fitch Ratings believes that these tax increases should help to provide long-term financial strength given that current revenues have been stagnant over the last few fiscal years.

Funding of the school budget is the largest single expenditure item of the city's general fund. School funding is a shared responsibility between the city and Virginia. Although the city annually allocates a contribution to the school budget, the city has no control over the use of funds. The school board is appointed by the city council, yielding the council greater control over school operations than school boards in other cities in Virginia that are separately elected. Enrollment trends have mirrored population stagnation, remaining flat to slightly declining over the past 10 years.

The solid waste fund, which is a city enterprise fund, experienced a slight operating deficit in fiscal years 2001 and 2002 due to revenue shortfalls attributable to private hauler contracts negotiated in 2001. During fiscal 2002, the city council authorized a comprehensive rate study to maintain the self-supporting nature of the system. As a result, in fiscal 2003, the city increased the private hauler tipping fee to $35 per ton from $32 per ton and increased the tire disposal fee to $2.00 from $1.00. Additionally, the city implemented in January 2004 a $5 per month per household service charge, also known as the common good fee. The fund is expected to end fiscal 2004 strong, with 1.6x coverage on the outstanding general obligation bonds issued for the utility.

■ Economy

Similar to other older, urban cities in Virginia, Lynchburg experienced declining population from 1980 to 2000. Recent estimates, however, show a stabilizing population with modest growth, 2.35% over the 2000 census. The current population is estimated at 66,800. Manufacturing in Lynchburg is important to the local economy, but the city also serves as the retail, health care, and higher education center for the region. Economic development efforts continue to focus on attracting higher paying manufacturing and research and development jobs into the designated industrial parks. The city's relatively affordable land and access to a more skilled workforce given its proximity to numerous higher education institutions should aid in this effort.

Unemployment figures increased over the last few years as a result of the shrinking technology and communications sector. Ericsson, which was once the world's leading suppliers in the telecommunications industry and the city's second largest employer, reorganized its Lynchburg operations in 2002, spinning off into Sanmina-SCI and M/A-Com, with a net loss of approximately 1,400 employees. As a result, unemployment rates during 2002 and 2003 were above 6%, but the most recent figures for March 2004 show a decrease to 5.6%; this figure consistently tracks above the state but below the national average. The state average as of May 2004 was 3.1% and the national average 6.0%.

Leading employers include Centra Health (4,000 employees), Areva (nuclear engineering; 1,700), Central Virginia Training Center (health care; 1,600), BWX Technologies, Inc. (nuclear fuel; 1,500), and GE Financial Assurance (1,200). Most of the largest employers are either currently in the process of expanding their Lynchburg facility or have recently completed an expansion. The largest employer, Centra Health, is in the process of a $200 million investment at its Lynchburg facility. Other notable investments include BWX Technologies, which announced a $41.1 million expansion, bringing an additional 320 employees to Lynchburg. Areva is in the process of adding 200 employees and investing $12 million in its facility. Frito-Lay, Inc., with about 400 employees, just announced plans for a $15 million expansion, which will bring an additional 50 employees to the plant. In addition, StarTek, Inc., a business processing outsourcing company, announced earlier this year its intention to locate in the city by July 2004 and provide 500 additional jobs.

Growth in the service sector continues, as Lynchburg maintains its position as a retail hub for the region. Service sector employment represents about 40% of total employment in the city. Recent retail announcements include a Home Depot and a Target; both retail stores mark the first for the region. Strong per capita retail sales reflect the city's established position as a retail center. Retail sales per capita in 2002 were 200% of state and national levels.

The city is also embarking on redevelopment of its downtown, approximately a 50-block area, with infrastructure improvements, culture and entertainment projects, commercial development, and government investment. Approximately $4 million of public investment has occurred thus far in streetscape improvements and the transformation of a railroad yard into a public park and open space. Cultural projects that are either complete or underway include an Amazement Square Children's Museum, a Dance Theatre of Lynchburg, a Renaissance Theater, and an Academy of Music Theater. Several lofts and condominiums are currently under construction, and three new restaurants opened within the past month. A new boutique hotel is planned to include 40 rooms, a conference center, a high-end restaurant, and a micro-brewery. The city relocated its human services department into a newly renovated historic building in the downtown area, and a new federal courthouse and post office is planned for construction within the next year. This project should provide growth in the city's tax base over the next decade as additional projects come on line.

Another project that is underway and should provide additional growth in the city's tax base is the Wyndhurst Town Center development. This planned unit development covers 500 acres and includes a mix of residential and commercial development. Originally set to be completed over a 15-year period, the project is slated for completion in five years.

Total assessed valuation (AV) in the city has grown an average 5.2% annually over the last five years and building permit values for 2003 equaled a strong 4.1% of AV. The city's tax base should continue to grow as the aforementioned projects are included in the tax roll.

Income levels are below average based on all indicators. Median household effective buying income equals 71.7% and 77.6% of state and national averages, respectively, in 2002, and per capita personal income equaled 74.2% and 78.8% of the state and national averages, respectively, during the same period. These numbers are a product of an economy concentrated on the manufacturing and service sectors, a large student population, and the lower cost of living in areas of central Virginia.